

HONG KONG 2000 – WHAT FOLLOWS THE FRAMEWORK AGREEMENT?

April 1, 1998

Hong Kong Convention and Exhibition Centre

Executive Summary

Theme

1. The theme of *Hong Kong 2000 - What Follows the Framework Agreement?* was really focused upon the difficulties in balancing the interests of consumers who are looking for greater choice over higher bandwidths at lower prices, and local service providers (the three new local FTNS operators, the callback operators and the ISPs) who have up to date made their money from callback services or international Internet traffic rather than the local loop. On the one hand, opening the international market to comprehensive competition radically transforms consumer choice. On the other hand, this move vitally threatens the ability of the new FTNS operators to finance a long-haul local loop build-out. This in turn raises questions over the viability of the particular model of open competition that has emerged in Hong Kong. This should not come as a surprise. Oftel in the UK was forced to abandon the duopoly model of competition pioneered in the 1980s. Austel was forced to radically alter its approach, and is now almost disbanded. In the USA, the FCC is struggling to reintroduce AT&T and other long-distance carriers into local loop competition a decade after breaking up AT&T. Hong Kong's model of competition is likely to undergo similar revisions. The key issues for local operators seem to revolve around three questions: (a) international connection or access fees, (b) who has the opportunity to provide the facilities as well as the services, and (c) how effective will regulatory enforcement of interconnection and other forms of local loop access be?

Keynotes

2. The keynote speakers, Norman Yuen (Deputy CEO, Hongkong Telecom) and Anthony Wong (Director-General, OFTA), set the scene. Norman Yuen, speaking on behalf of Hongkong Telecom as top tier sponsor of the TIF for 1998, stressed the need for government and industry to collaborate in a world where the rapid growth of cyberspace is posing important new challenges to economic and social life. He instanced the threat of the '2000 bug' to illustrate just how important issues of electronic communications had become to the life-pulse of a community. This is an important theme. Telecommunications is not just about providing individual customers with high-quality services at reasonable prices, it is also about important 'externalities' which influence the regional and competitive position of Hong Kong as a whole. Government policies must inevitably influence the scope and direction of these externalities, as the IAC set up under OFTA has been examining. Anthony Wong, who is now conducting

the review of telecommunications policies following the Framework Agreement, reiterated OFTA commitment to promoting a competitive environment. He assured the forum that under the Framework Agreement OFTA retains powers to declare a company dominant in a particular market, and in this sense, as Alex Arena has stressed, the Agreement actually broadens OFTA's powers insofar as all international services will now come under the FTNS form of licence conditions. During discussion it was further reiterated that OFTA retains the powers to control retail prices - and, if necessary, to determine wholesale prices - even after price-caps have been removed. Both speakers stressed the importance of shifting the emphasis from regulation to competition.

Session One

3. The speakers of the first session, Leslie Harris (NT&T), Charles Mok (Internet Service Providers Association) and Simon Chan (Hong Kong Telecom Users Group), directed their remarks to the future of local service providers. Leslie Harris' principal point was that effective regulation was necessary -- 'the cornerstone' -- to ensure effective competition at the local level, and while his appraisal of OFTA's performance was positive he underlined the lack of a determination on interconnect, and the lack of an interconnect for ISDN. He also stressed the crucial importance of investor expectations in government, and OFTA's, policy and regulatory approaches. This point highlights the local vs. global dichotomy that the Framework Agreement has opened up. The other important issue he raised was the issue of regulatory balance, or lack of, across markets. In particular, why was Wharf Cable not allowed to offer telecoms services over its network? There were too many policy and regulatory anomalies arising as technologies and business cases changed.

4. Charles Mok took up this theme, again instancing the lack of ISDN interconnect which was hampering the fastest growing sector of the industry in Hong Kong. The World Wide Wait, as it was becoming known, was holding Hong Kong back from achieving its goals, due to the lack of bandwidth, especially to the USA. This is another instance of externality which must be taken onboard by the policy-makers. He also raised the issue of standards, or lack of agreement about them which was impeding not only technology progress but even more crucially applications and the infrastructure to support them. This is again an externalities issue, but a more difficult one to handle since investment in technologies and applications standards involves risk and uncertainty. There will be a time lag between new services and their mass marketing if standards issues are not resolved, and this time lag may prove critical for local service providers (FTNS as well as ISPs) in light of a sudden upsurge in competition from an open international market. Charles Mok made the point that the ISP market, in many ways, is a model of competition which may not survive the new model. The implication seems to be that in the new open international model local ISPs should be given every opportunity to benefit on an equal footing.

4. Simon Chan gave the business users' perspective of HKTUG. He itemized the gaps in the current levels of service provision, including high-speed Internet access and broadband access to buildings, and high prices for broadband circuits. For these reasons innovation in higher-bandwidth local services was still rather poor, an important issue if Hong Kong is to sustain its international and regional appeal despite a relatively highly valued currency and extremely high prices of hotel accommodation, office and residential floor-space. Domestic local loop build-out and competition was also a disappointment, and he distinguished between the need for tight regulation in the area of facilities competition compared with lighter-handed regulation in the area of services competition. Again, he stressed an externalities issue in giving emphasis to the need for an information infrastructure which provided all sectors of Hong Kong with affordable online access.

5. There was some discussion from the floor as to whether the very liberal Hong Kong model, for example towards ISPs, had been justified in light of the number of uneconomic players of uncertain quality. Obviously the policy cannot change now, but the counterview was put that while competition may not be the complete answer to the quality problem it was effective in selecting the most able to survive. The wider issue of e-commerce was also aired, with a participant reminding the forum that the OECD was putting together recommendations on how to regulate it. Other discussion ranged from issues of dominance and the tariffs placed upon broadband networks, to questions of how far and how fast local tariffs would be rebalanced. Hongkong Telecom's position was stated as in favour of complete rebalancing to drive out any remaining cross-subsidy.

Session Two

6. Alistair Grieve (Deputy CEO, Hongkong Telecom) gave the background to HKT's decision to renegotiate the international licence. It was no longer appropriate after so many new technologies and services had overtaken the industry since the 1981 licence was issued, especially as they in effect allowed traffic to by-pass the international tariff. Abolishing the local subsidy was an essential part of the deal to open money-making opportunities domestically. On the deal itself, HKT's main objective had been to maintain shareholder value, which was subsequently confirmed by the market. The key point raised for the future really seems to be this one about money-making opportunities in the domestic market. But while tariff rebalancing may be necessary it may not be sufficient, and this means considerable innovation needs to take place in pioneering and open up local value-added opportunities.

7. Steve Liddell (President Asia-Pacific, Worldcom) brought the forum's attention to the fact that the entire paradigm of telecoms was changing from one based upon voice cables to one based upon data and bandwidth, which changed the entire economics of the business. Internet and deregulation are leading these changes, but the challenge is to integrate the local optical fibre network into a world web of gigabit capacity. This

required vision and commitment in the form of investment which can only come from an open market and the opportunities that gives rise to. This viewpoint clearly challenges in the most fundamental way all local vested interests, because it implies that only the international players really have the scale of investments required to provide the guaranteed bandwidth-on-demand necessary for a packet-switched world of e-communications. What follows is a challenge therefore to both government and local companies to come to terms with the new rules of the game. The alternatives, restricted entry or periods of transition and exclusivity, clearly do not answer this investment challenge. Even the idea of high access fees to provide local service operators with revenue is insufficient given that the Hong Kong's market is small in absolute terms.

8. Paul Cheng (GM, City Telecom) gave TIF the local operator's perspective. He estimated that the three new FTNS operators should have netted from delivery fees around HK\$1 billion over the past year alone. Although they have a wired service in principle they are no different from the PCN or mobile operators except they have special privileges to provide ISR and facilities-based competition. He attacked the idea that this privilege should continue at the expense of other local service providers, and what he interpreted as OFTA's implication that their current delivery fee arrangements should be safeguarded, at least for the short term. He quoted 5 US cents as having been stated as the US-end access fee, but this included long-distance. At the city-level it was closer to 1US cent, closer in comparison to 4.2 HK cents PNETS charge for ISPs. If FTNS operators in Hong Kong were permitted to levy the higher charge then delivery fees would amount to 60 per cent of the costs of non-FTNS ISRs. This would drive out the ISP competitors long before they had the chance to enter the facilities market. He announced that CTI and ISPs were in an alliance to monitor the situation. His contribution really highlights that there are at least three competing interests: international carriers + HKT, local FTNS and other local operators. The real challenge to government is how far to go to attract capacity investment from the international carriers or to protect the FTNS from the international carriers and the ISPs from the FTNS.

9. In a lively discussion around many of these points, one major user complained of Hong Kong losing its regional competitiveness in terms of the price of leased capacity, stressing this outweighed problems of the local loop. During the discussion Alex Arena clarified that international gateway facility operators would be given a, if necessary restricted, form of FTNS licence, although the exact details were still under review. Possible difficulties of obtaining IRUs (indefeasible rights of usage) on submarine cables or satellite circuits were raised, as were problems of lags in building new cable capacity. John Ure in his briefing paper (to be available on the TIF page of www.trp.hku.hk and www.hkbu.edu.hk/~hktug) took up this issue, along with the major dent in revenues that will result from access fees close to 4.2 HK cents after ISR has by-passed the accounting and settlement rate system. He proposed government should consider either negotiating a price of entry from international carriers in terms of either investment commitments (cable landings) or encouraging FTNS and other local operators to

negotiate 'corresponding relationships' with international carriers to secure IRUs, traffic agreements and other joint benefits.

Conclusion

10. In conclusion: it is clear that the competitive model for telecommunications in Hong Kong will undergo radical changes. Being a hub implies international inward investment and that implies international carriers connectivity to local loops, but it does not necessarily mean the end of effective local competition. Instead it implies new partnerships and alliances. The danger lies in these being shifting sand. If they are partnerships only at the service level they will, in all likelihood, be short-lived. They need to be cemented in network and facilities investments, and access to facilities. Hong Kong needs to move rapidly into the broadband era. Although a separate issue, there may be a role also for the government in social investment in the information infrastructure which could provide a valuable domestic market for local service providers. Government also needs to consider further the conditions that stimulate local innovation. Removing out-of-date restrictions upon networks of different types is one way. The importance of e-commerce to Hong Kong's future and its promotion is another tool for policy-making. This is where the issue of standards may play a crucial role. It is clear that it is now impossible to discuss future telecoms policies without several related areas converging. That is the sign of the digital times we live in, so government also needs to develop a framework for methodically integrating them into policy-making. That is a major challenge for the new ITBB and the IT Commission, and is the subject of the second quarterly TIF.